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UNCLAS SECTION 01 OF 13 ZAGREB 000026

SIPDIS

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SUBJECT: CROATIA 2009 INVESTMENT CLIMATE STATEMENT

REF: 2008 STATE 123907

¶1. Summary: Croatia has enjoyed steady growth in foreign investment over the last several years, buoyed by a growing economy, low inflation, a stable exchange rate and developed infrastructure. With progress towards membership in NATO and the European Union well advanced, Croatia has taken a leading position in the SE Europe region, with the expectation that Euro-Atlantic integration will provide further stimulus for investment and growth. However, despite progress in economic and administrative reforms, problems remain. These include a judiciary plagued by case backlogs, overly complex bureaucracy, corruption and the country's relatively high costs. Nevertheless, many foreign investors are prospering in this growing market. End Summary.

A.1 Openness to Foreign Investment

¶2. Croatia is open to foreign investment. The Croatian government continues to have as a goal a further increase in foreign investment. Future NATO and EU membership continue to motivate both reform and stabilization of the economy, in turn improving the investment climate of the country. The government has also given priority to activities related to fighting organized crime and corruption by appointing new ministers of interior and justice, as well as a new national police chief.

¶3. Croatia's legal framework accords equal treatment to foreign and domestic investors for all types of business. There are no reviewing or screening mechanisms to exclude foreign investment, nor are there any restrictions to foreign investment. The Internet website of the Croatian Chamber of Economy (www.hgk.hr) provides a useful English-language guide, "How to Start Up an Enterprise in Croatia," as well as sector-specific and general reports. The Zagreb Stock Exchange's website (www.zse.hr) posts English-language translations of key laws in force.

¶4. Despite recent progress, however, problems remain that dampen investment in Croatia. Of these, the greatest is the country's legal system. Amid a backlog of just under a million pending cases, even the simplest cases can take years to resolve. The result is that, in spite of laws that govern the sanctity of contracts, timely enforcement is a problem. The difficulty of obtaining timely judicial remedy in a dispute has hindered investment in Croatia. Other problem areas include inefficient bureaucracy and the country's relatively high labor costs in relation to other locations in Central and Eastern Europe.

¶5. The Agency for Trade and Investment Promotion has a mandate to match potential investors with projects in Croatia. The Agency has specialists available in strategic planning, investment support and export support (see www.apiu.hr) and is actively seeking projects that it can promote to foreign investors. The Agency is also active in advising the government on how to make Croatia's regulatory environment more transparent and competitive.

¶6. The Company Act defines the forms of legal organization for domestic and foreign investors. The following are permitted for foreigners: general partnerships, limited partnerships, branches, limited liability companies, and joint stock companies. The Obligatory Relations Law regulates commercial contracts.

A.2 Conversion and Transfer Policies

¶7. The Croatian constitution guarantees the free transfer and repatriation of profits and invested capital for foreign investments. Article VI of the U.S. Croatia Bilateral Investment Treaty (BIT) establishes protection for American investors from government exchange controls that limit current and capital account transfers, and limits on inward transfers made by screening authorities. The BIT obliges both countries to permit all transfers relating to a covered investment to be made freely and without delay into and out of each other's territory. The Croatian Foreign Exchange Law permits foreigners to maintain foreign currency accounts and to make external payments.

¶8. The Foreign Exchange Law also defines foreign direct investment (FDI). For example, use of retained earnings for new investments/acquisitions is considered FDI, whereas investments made by institutional investors such as insurance, pension and investment funds are not considered FDI. The law also liberalizes foreign exchange transactions for Croatian entities and individuals allowing them to invest abroad. Generally, this law liberalized foreign exchange transactions, but it also introduced criteria for the possible imposition of capital controls.

¶9. The U.S. Embassy in Zagreb has not received any complaints from American companies regarding transfers and remittances.

ZAGREB 00000026 002 OF 013

A.3 Expropriation and Compensation

¶10. There have been no cases of expropriation of foreign investments by the government since Croatia became independent in 1991. Article III of the BIT covers both direct and indirect expropriations. The BIT bars all expropriations or nationalizations except those that are for a public purpose, carried out in a non-discriminatory manner, are in accordance with due process of law, and are subject to prompt, adequate and effective compensation.

¶11. Croatian law gives the government broad authority to expropriate property under various economic and security related circumstances. The law provides for an appellate mechanism to challenge expropriation decisions by means of a complaint to the Ministry of Justice within 15 days of the expropriation order. The law, however, does not describe the Ministry's adjudication process and the fact that the Ministry of Justice represents the government, which initiates expropriations, is an area of potential concern for investors.

A.4 Dispute Settlement

¶12. There have been few instances of investment disputes involving U.S. companies in Croatia. As a result of the very long timeframes involved in obtaining judgments in court, companies often try to resolve disputes without seeking judicial remedy. The government is currently working to reduce court backlogs and to encourage the use of alternative dispute settlement.

¶13. The Croatian constitution provides for an independent judiciary. The judicial system consists of courts of general and specialized jurisdictions, whose core structure is Supreme Court, County Courts, Municipal Courts, and the Magistrate/Petty Crimes Courts. Specialized courts include the Administrative Court and High Commercial and Lower Commercial Courts. There is also a Constitutional Court that determines the constitutionality of laws and government actions and protects and enforces constitutional rights. Municipal courts exercise original jurisdiction over civil

and juvenile/criminal cases. The High Commercial Court is located in Zagreb and has appellate review of lower commercial court decisions. Modification of lower court decisions by the High Commercial Court may be appealed to the Supreme Court.

¶14. The Administrative Court has jurisdiction over the decisions of administrative bodies of all levels of government. The Supreme Court, under certain circumstances, may review decisions. The Supreme Court is the highest court in the country and, as such, enjoys jurisdiction over all civil and criminal cases. It hears appeals from County, High Commercial, and Administrative Courts.

¶15. The government continues efforts to reform the judiciary, including reducing the backlog of cases, reforming the land registry, training court officers and reducing the backlog and length of bankruptcy procedures. Alternative dispute resolution has been implemented at the High Commercial Court, the Zagreb Commercial Court and 6 municipal courts throughout the country. An important move to lessen the backlog of cases is the on-going redistribution of non-disputed decisions to public notaries. During the past year, the number of pending cases has decreased to fewer than 950,000, down from one million. The greatest reduction was in the backlog of enforcement cases and the enforcement of judgments currently makes up 12 percent of all pending cases. According to the provisions of the Law on Enforcement, a judgment made by a judge or panel of judges to order payment or direct actions to be taken or ceased must be executed immediately per such decision. Current practice, however, delays enforcement until all appeals are exhausted. Article 17 of the Law on Enforcement states that foreign judgments may be executed only if the "judgment fulfills the conditions for recognition and execution as prescribed by an international agreement or the law." The Ministry of Justice's reform plan is available on its website at www.pravosudje.hr.

¶16. The Law on Bankruptcy, internationally harmonized and corresponding to the EU regulation on insolvency proceedings and United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency, establishes timeframes for the initiation of bankruptcy proceedings. Bankruptcy and foreclosures have traditionally been slow and inefficient in Croatia. A World Bank funded project, "Technical Assistance Associated with Bankruptcy Proceedings," which ended in January 2007, helped the advancement of company court administration through the introduction of an information and legal system for bankruptcy trustees, which was to assist in shortening bankruptcy proceedings. The World Bank has estimated that the recovery rate in Croatia is approximately 44.5 percent of the Organization for Economic Cooperation and

ZAGREB 00000026 003 OF 013

Development (OECD) average, and somewhat better than the regional average.

¶17. The Commercial Court has exclusive jurisdiction over bankruptcy matters. A bankruptcy tribunal decides on initiating formal bankruptcy proceedings, appoints the trustee, reviews creditor complaints, approves the settlement for creditors, and decides on the closing of proceedings. The bankruptcy judge supervises the trustee (who represents the debtor) and the operations of the creditors' committee. A creditors' committee is convened to protect the interests of all creditors during the proceedings, to oversee the trustee's work and to report back to the creditors. The law establishes the priority of creditor claims, assigning higher priority to those related to taxes and revenues of state, local and administration budgets. The law also allows for a debtor or the trustee to petition to reorganize the firm, an alternative aimed at maximizing asset recovery and providing for fair and equitable distribution among all creditors.

¶18. Arbitration is available, although underutilized. Within the Croatian Chamber of Economy, there is a permanent arbitration court that has been in existence since 1965 (see www.hgk.hr/wps/portal/!ut/p/.cmd/cl/1/hr). Arbitration is voluntary and conforms to UNCITRAL model procedures. The court received 53 new cases in 2008 and is currently reviewing a total of 153 cases.

¶19. The English-language text of the Law on Arbitration can be found on the website of the Croatian Chamber of Economy (www.hgk.hr). The law covers domestic arbitration, recognition and enforcement of arbitration rulings, jurisdictional matters, and procedures. Once a dispute has been arbitrated the decision is executed upon notice from the court to the obligatory party. If no payment is made by the established deadline, then the party benefiting from the decision notifies the commercial court and the commercial court becomes responsible for enforcing compliance. Rulings of the arbitration court have the force of a final judgment, but can be appealed within three months.

¶20. Article X of the BIT sets forth several means for resolution of investment disputes, defined as any dispute arising out of or relating to an investment authorization, an investment agreement, or an alleged breach of rights conferred, created, or recognized by the BIT with respect to a covered investment. For more information on the BIT arbitration provisions, consult <http://tcc.export.gov>.

¶21. Croatia is a signatory to the following international conventions regulating the mutual acceptance and enforcement of foreign arbitration: the 1923 Geneva Protocol on Arbitration Clauses, the 1927 Geneva Convention on the Execution of Foreign Arbitration Decisions, the 1958 New York Convention on the Acceptance and Execution of Foreign Arbitration Decisions, and the 1961 European Convention on International Business Arbitration. In 1998 Croatia ratified the Washington Convention - the International Center for the Settlement of Investment Disputes (ICSID), and it became effective on October 22, 1998.

A.5 Performance Requirements/Incentives

¶22. Croatia's WTO Trade Related Investment Measures (TRIMs) agreement went into effect in 2000. Croatia has no trade-related investment measures in place at the present time, nor does the government intend to introduce any such measures in the future. Accordingly, Croatia did not seek to list any measures for elimination under the provisions of the WTO Agreement on TRIMs. Croatia committed to maintaining measures consistent with the TRIMs agreement and has applied the TRIMs agreement from the date of accession without recourse to any transition period.

¶23. Croatian law does not impose performance requirements on foreign or domestic investors. Article VII of the BIT prohibits mandating or enforcing specified performance requirements as a condition for the establishment, acquisition, expansion, management, conduct, or operation of a covered investment. The list of prohibited requirements is exhaustive and covers domestic content requirements and domestic purchase preferences, the "balancing" of imports or sales in relation to exports or foreign exchange earnings, requirements to export products or services, technology transfer requirements, and requirements relating to the conduct of research and development in the host country. Article VII makes clear, however, that a party may impose conditions for the receipt or continued receipt of benefits and incentives.

¶24. In late 2004, the Ministries of Economy and Defense agreed to introduce offsets (a requirement for local sourcing of a portion of the contract) for defense procurements over 2 million euros, and the Ministry of Economy said it was looking at introducing offsets in

ZAGREB 00000026 004 OF 013

other areas, however no such action has been undertaken. More information on application and regulation of the offset program can be found at www.hgk.hr.

¶25. As of January 1, 2007, the Investment Promotion Law offers potentially significant incentives (the amount of which is dependent upon the percentage of unemployment in the respective county) to investors, foreign and domestic, such as 1500-3000 EUR incentive per new job position, assistance with retraining and tax incentives. It provides for incentives that apply only to investments in production based businesses, technological development centers and strategic business support activities. The minimum amount of investment that qualifies for incentives is 300,000 EUR. Tax incentives include

substantially lower profit tax obligations and customs relief. The text of the law is available on the Croatian National Bank site (www.hnb.hr).

¶26. Incentives include 10 percent corporate tax for ten years for companies that invest from 2.2 million to 11 million HRK (approximately \$440,000 - \$2.2 million) and create 10 new jobs; 7 percent corporate tax for ten years for companies that invest from 11 million to 30 million HRK (approximately \$2.2 million to \$6 million) and create 30 new jobs; 3 percent corporate tax for ten years for companies that invest 30 million to 58 million HRK (approximately \$6 million to \$11.6 million) and create 50 new jobs; 0 percent corporate tax for ten years for companies that invest over 60 million HRK (approximately \$11.6 million) and create at least 75 new jobs.

¶27. Incentive measures refer to investment in the following: new equipment and modern technology, new production processes and new products, greater employment and education of workers, modernization and growth of business, development of production with a higher level processing, an increase in exports, increasing economic activity in regions of Croatia in which economic growth and employment levels lag behind national averages (in accordance with the map of regional areas of special state concern), development of new services, energy conservation, strengthening information technology, cooperation with foreign financial institutions, and harmonizing the Croatian economy with EU standards.

¶28. Investors may also be eligible to receive assistance from the government to offset costs of employee re-training. The government may offer real estate (or permits or infrastructure) to an investment either cost-free or on a preferential basis. Finally, the government will allow the duty-free importation of capital equipment for the investment.

¶29. The Croatian government also offers incentives for business activities carried out in the areas of special state concern, mountain areas and the city of Vukovar. The laws governing business activities in the areas of special state concern have been harmonized with EU regulations on state aid. Various categories of tax incentives are offered per area and further information can be requested from the Trade and Investment Promotion Agency (www.apiu.hr).

¶30. The Trade and Investment Promotion Agency can be helpful in identifying and applying for investment incentives. Also, the (separate) Office of Investment and Export Promotion in the Ministry of Economy can be helpful in looking for incentive information. Further information can be found on their website at www.mingorp.hr.

¶31. Although procedures for obtaining business visas are generally clear, they can be cumbersome and time-consuming. Furthermore, the Government amended legislation during the summer of 2007, setting up new requirements for temporary residency. Article 56 of the Law on Foreigners now requires that a person seeking temporary residency for family members must, themselves, have been in Croatia for at least two years before such residency would be issued to their family members. Interested parties should inquire regarding the status of this law, as it is to be amended during the first quarter of 2009. Questions relating to visas and work permits should be directed to a Croatian embassy or consulate. The U.S. Embassy in Zagreb also maintains a website with information on this subject at www.usembassy.hr.

A.6 The Right to Private Ownership and Establishment

¶32. Both foreign and domestic legal entities have the right to establish and own businesses and engage in remunerative activity. Foreign investors can acquire ownership and shares of joint stock companies. The lowest amount of initial capital for establishing a joint stock company is 200,000 HRK (\$40,000) and the nominal value per share cannot be less than 10 HRK (\$2.00). Minimum initial capital for establishment of a limited liabilities company is 20,000

HRK (\$4,000), while individual representation per investor cannot be less than 200 HRK (\$40.00)

As a rule, the import and export of goods are free. Quotas or protective levies may be introduced in accordance with WTO rules only as an exception if the balance of payments experiences disturbances. If the import of certain goods threatens to damage or damages domestic industry, import quotas may be introduced. Export quotas may also be set in order to protect national non-renewable natural resources, accompanied by restrictive measures that limit internal trade in these products.

133. Article 49 of the Constitution provides assurances that all entrepreneurs have equal legal status and that monopolies are forbidden. The Competition Act defines the rules and methods for promoting and protecting competition. This law and information about the Croatian Competition Agency can be found at www.aztn.hr. In theory, competitive equality is the standard applied to private enterprises in competition with public enterprises with respect to market access, credit and other business operations, such as licenses and supplies. In practice, however, state-owned enterprises and "strategic" firms continue to receive preferential treatment, including government bailouts and subsidies.

134. The Government's e-government initiative "Hitro" (www.hitro.hr) has an on-line business registration component that reduces the time it takes to register a company to four days. Business registration is the first step in a plan to make more government services available on-line in coming years and includes the full digitization of Croatia's land records (see www.pravosudje.hr and www.katastar.hr to find digitized land records).

A.7 Protection of Property Rights

135. The right to ownership of private property is established in the Croatian Constitution and numerous acts and regulations safeguard this right. A foreign physical or legal person incorporated under Croatian law is considered to be a Croatian legal person. The Law on Ownership and Property Rights establishes procedures for foreigners to acquire property by inheritance as well as legal transactions such as purchases, deeds, and trusts. The right of foreigners to acquire property in Croatia is based on reciprocity. Reciprocity exists on state-by-state basis with the United States. Croatia's Ministry of Foreign Affairs has confirmed the existence of reciprocity for real estate purchases for residents of the following states: Alabama, Arizona, Alaska, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Georgia, Idaho, Louisiana, Maine, Massachusetts, Michigan, Montana, Nevada, New Jersey, New York, North Carolina, North Dakota, Rhode Island, Tennessee, Texas, Virginia, Washington, West Virginia, Iowa and Oklahoma (with a condition of permanent residence). Residents of other states could face longer waiting periods while the Ministry confirms that Croatian nationals can purchase real estate in those states without restrictions. However, a foreign investor, incorporated as a Croatian legal entity, may acquire and own property without ministry approval. Purchasing by any private party of certain types of land (principally land directly adjacent to the sea or in certain geographically designated areas) can be restricted. Both Croatian and foreign citizens may mortgage property and pledge real and tangible property.

136. In order to acquire property by means other than inheritance or as an incorporated Croatian legal entity, foreign investors require the approval of the Ministry of Justice. Approval often takes several months or longer owing to a lengthy interagency clearance process. When purchasing land for construction purposes, potential buyers should determine whether the property is classified as agricultural land or construction land. Two controversial laws passed in December of 2008 should be considered when purchasing land. The Arable Land Law allows for additional fees of 25 percent or more to be added to the initial cost of land that is to be converted from agricultural into construction land. The Law on Golf Terrains allows investors to expropriate land from private owners and local governments in order to build golf courses.

137. Clarifying Croatia's land registry system is an on-going

process. Although Croatia has made progress resolving a backlog of cases, potential investors should seek a full explanation of land ownership rights before purchasing property. It is highly advisable to seek competent, independent legal advice in this area (see www.usembassy.hr, Consular section for a list of English-speaking attorneys), as there are sometimes ambiguous and conflicting claims to property, making it necessary to verify that the seller possesses clear title to both land and buildings, which can be titled and owned separately. Inheritance laws have led to a situation in which some properties can have dozens of legal owners, some of whom are long since deceased and others of whom emigrated and cannot be

ZAGREB 00000026 006 OF 013

found. It is also important to verify the existence of necessary building permits, as some newer structures in coastal areas have been subject to destruction at owner's expense and without compensation for not conforming with local zoning regulations. Investors should be particularly wary of promises that structures built without permits will be regularized retroactively.

¶38. Some aspects of land ownership, as distinct from ownership of objects, are not clear. Investors interested in acquiring companies from the Croatian Privatization Fund should seek expert legal advice to determine whether any deal also includes the right to ownership of the land on which an object is located, or merely the right to lease the land through a concession. The various Croatian laws on privatization are not clear on this point.

¶39. Inconsistent regulations and restrictions on coastal property ownership and construction have in the past provided challenges for foreign investors. Legislation restricts coastal construction and commercial use within 70 meters of the coastline.

¶40. Croatia has intellectual property rights legislation, including the Patent Law, Trademark Law, Industrial Design Law, Law on the Geographical Indications of Products and Services, Law on the Protection of Layout Design of Integrated Circuits, and Law on Copyrights and Related Rights. Although some areas of IPR protection remain problematic, Croatia is currently not on the U.S. Special 301 Watch List in 2007. Problem areas continue to be concentrated in piracy of digital media and counterfeiting.

Due to its geographical position, Croatia is also one of the transit routes for various contraband products bound for other countries in the region.

¶41. As a full WTO member, Croatia is a party to the Uruguay Round Agreement on Trade-Related Intellectual Property Rights (TRIPS). A WTO/TRIPS Working Group in June 2001 accepted Croatia's IPR legislation. Texts of these laws are available on the website of the State Intellectual Property Office: www.dziv.hr. Croatia is also a member of the World Intellectual Property Organization (WIPO). For a list of international conventions to which Croatia is a signatory, consult the State Intellectual Property Office's website.

A.8 Transparency of the Regulatory System

¶42. Croatia is under pressure to increase transparency and its commitments to adopt EU laws, norms, and practices, provide steady pressure for reform. Nevertheless, bureaucracy and regulation continue to be overly complex and time consuming.

¶43. In 2006, the Croatian government, with the assistance of USAID, began the Hitrorez project, which aims to remove needlessly complex bureaucracy as an obstacle to investment, targeting the 1451 laws and regulations that affect business in Croatia. At the end of its first phase in mid-2007, Hitrorez identified 799 regulations for simplification or elimination. Hitrorez recommendations for 500 of the regulations were accepted and 359 were implemented as of January 2009, with plans to implement the remaining recommendations by the end of 2009.

¶44. Legislation on public procurement, accounting and financial security was passed in 2007 with the intent to increase

transparency. An amended Company Law was passed in December 2008. The procurement law provides for greater transparency with the introduction of electronic auctions, definitions of special procurement procedures and framework agreements, as well as publication of all procurement procedures over 70,000 HRK (\$14,000). The new Accounting Law includes reporting provisions according to which large companies will apply International Financial Reporting Standards, while small and medium businesses will apply Croatian Financial Reporting Standards. Progress, however, is still necessary in this area.

¶45. Bureaucracy is still a major challenge for foreign investors, although the government has made progress in this area, particularly through the development of its e-government initiatives (see paragraph 34). Property registration, for example, has traditionally been notoriously inefficient, sometimes taking up to several years. However, recent reforms and the digitization of the land registers are hopeful signs that this problem will be mitigated in the near future (see paragraph 34). A valuable source of analysis is located on the website of the Croatian office of the World Bank, at www.worldbank.hr. Click on the link for the "Doing Business in Croatia Forum."

¶46. The regulatory system does not specifically discriminate against foreign investors. However, transparency in developing legislation

ZAGREB 00000026 007 OF 013

and regulation is often hampered by an inefficient public administration, a lack of intra-governmental coordination, and reliance on expert advice from national champions, sometimes giving the latter a privileged position in influencing new regulations.

¶47. Tax on corporate income is a flat 20 percent. There is a 15 percent tax on interest revenue and royalties. In 2005, tax on dividends was eliminated as a spur to investment. For a detailed description of extant tax legislation, please consult the Tax Administration's website at www.porezna-uprava.hr/en/index.asp. Detailed information about customs can be found at www.carina.hr.

¶48. The Institute of Public Finance maintains a useful table of Croatian taxes at www.ijf.hr/eng/taxguide/08_05/taxtable.pdf. Croatia also maintains a 22 percent value-added tax (VAT). Some companies have had difficulty with the tax authorities due to differing understandings of how certain goods and services are affected by the VAT.

A.9 Efficient Capital Markets and Portfolio Investments

¶49. Croatia's markets are open to both domestic and foreign investment equally. There are no restrictions that would disrupt foreign investment in the securities market and other markets in Croatia. Foreign residents may open non-resident accounts and may do business both domestically and abroad. Article 24 of the Foreign Currency act states that non-residents may subscribe, pay in, purchase or sell securities in the Republic of Croatia in accordance with regulations governing securities transactions. Non-residents and residents are afforded the same treatment in spending and borrowing. These and other non-resident financial activities regarding securities are covered by Articles 24, 25 and 27 of the Foreign Currency Act, which can be viewed on the Central Bank website (www.hnb.hr).

¶50. The government passed a new Capital Market Act in July 2008. It entered into force on January 1, 2009. The new Act focuses on (1) the regulation of establishment of activities, supervision and cessation of investment companies, market operators and operators of payment and settlement systems; (2) the offering of investment services and the performance of investment activities; (3) the rules of trading on the organized market; (4) the offering and quotation of securities on the organized market; (5) the reporting requirements on connection with securities quoted on the organized market; (6) market abuse; (7) the deposit of financial instruments and the settlement and payment of transactions with financial instruments; and (8) the authority and activities of the Croatian Financial Services Supervisory Agency (HANFA) in connection with

implementation (see paragraph 53). The new Act will improve securities regulation and will increase transparency. Experts have said that it will cause some investment companies to disappear while making others stronger.

¶51. Croatia's capital markets did not do as well in 2008, after record levels of trading in 2007. Share values declined by 67 percent, from HRK 350 billion (\$ 70 billion) to 140 billion (\$20 billion) making 2008 the worst ever trading year since the establishment of the Zagreb Stock Exchange. According to the Central Depository Agency records, approximately 856,000 Croatian citizens now own stocks.

¶52. The Investment Fund Law provides for the establishment of derivative funds, index funds and other funds in accordance with EU legislation.

¶53. The Agency for Supervision of Financial Services (HANFA), headed by the Directorate for Supervision of Agencies oversees the capital market in Croatia. See www.hanfa.hr for all legislation and information relative to capital markets. Only an authorized company (brokerage houses and banks) may deal in securities in Croatia. Such activity must be licensed by the Croatian Financial Services Supervisory Agency and entered in a court register. A brokerage company may only be a private or public limited company based in the Republic of Croatia. Its only permitted activity is transactions in securities. The type of permitted activity depends on the amount of share capital. In accordance with national law, a brokerage company may establish a branch abroad in order to deal in securities in the respective country. Foreign brokerage companies authorized for transactions in securities may establish a branch in the Republic of Croatia, provided they obtain a license from HANFA.

¶54. The privatized and consolidated banking sector is advanced and is becoming more competitive. More than 90 percent of the total assets of the banking sector are foreign owned. By the 3rd quarter of 2008, there were 33 commercial banks and five savings banks,

ZAGREB 00000026 008 OF 013

whose assets totaled 354.2 billion HRK (\$71 billion). Italian-owned Zagrebacka Bank (23.19 percent) and Privredna Bank (17.04 percent) are the two largest banks per percentage of total bank assets in Croatia.

¶55. The government uses the market to finance government expenditure. Government debt instruments must be bought through an intermediary such as a commercial bank, and are tradable on exchanges.

¶56. Currently, securities are traded on the Zagreb Stock Exchange (ZSE), established in 1991. The Varazdin Stock Exchange (VSE), which was established in 1993 as an over-the-counter (OTC) merged into the ZSE in 2007. The OMX X-Stream trading system is now used on the ZSE.

¶57. The Securities Law requires that all companies with more than 100 shareholders and with share capital of at least HRK 30 million (approximately \$5.4 million) be listed on the newly established quotation for public stock companies (JDDs). The intention was to increase transparency and encourage companies to obtain low cost equity financing, which would result in increased turnover and trade volumes.

¶58. All Croatian workers under age 40 are required to pay five percent of their gross salary into a pension fund of their choice. EU Pillar III (additional voluntary savings with government matching of 25 percent) has also been introduced. Croatian financial markets are benefiting from this infusion of capital.

¶59. In 2008, transactions on the Zagreb Stock Exchange totaled 31.06 billion HRK (approximately \$6.03 billion), of which 11.69 billion HRK (approximately \$2.27 billion) was institutional turnover. Transactions in 2007 were 66.49 billion HRK (approximately \$13.34 billion), of which 39.05 billion HRK (approximately \$7.83

billion) was in institutional turnover.

¶60. There are three tiers of securities traded on the ZSE. Companies must meet high disclosure and operating requirements to be fully listed (quotation I). A detailed explanation of all requirements is provided at www.zse.hr in English.

¶61. The Croatian Chamber of Economy provides a useful summary of the capital markets in Croatia at www.hgk.hr.

A.10 Political Violence

¶62. The risk of political violence in Croatia is low. Following the break up of Yugoslavia and the subsequent wars in the region, Croatia has emerged as a stable, democratic country on the threshold of NATO membership. Membership in the European Union is also likely in the coming years. Relations with neighboring countries are generally good and improving, although some disagreements regarding border demarcation remain.

¶63. There is little domestic anti-American sentiment. There have been no incidents involving politically motivated damage to American projects or installations in Croatia.

A.11.a Corruption

¶64. Corruption remains a problem in Croatia. The EU highlighted corruption as a major challenge in its November 2008 progress report on Croatia's accession negotiations and citizens continue to cite corruption as one of the most important problems plaguing their society.

The Croatian government recognizes corruption as a problem and has made statements of will to combat corruption. The government has been working to implement the anti-corruption strategy adopted on June 19, 2008, and the action plan accompanying the strategy, adopted on June 25, 2008. The strategy defines the anti-corruption policy over an extended period of time and targets several key areas. The action plan includes specific measures with clearly defined deadlines for implementation. While the will to fight corruption has been expressed by the government, high level prosecution and sentencing for corruption are still lacking. There are cases of alleged corruption involving city officials and businessmen, but none have yet resulted in convictions.

¶65. Croatian laws and provisions regarding corruption apply equally for both domestic and foreign investors. According to the head of the state prosecutor's office for the suppression of corruption and organized crime (USKOK), the most recent prosecutions for corruption involve mostly Croatian citizens.

ZAGREB 00000026 009 OF 013

¶66. Croatia has ratified the Council of Europe Criminal Law Convention on Corruption, the Council of Europe Civil Law Convention on Corruption, and the United Nations Convention Against Transnational Organized Crime and has signed and ratified the United Nations Convention Against Corruption. Croatia has not ratified The OECD Convention on Bribery.

¶67. Croatia is a member of the Group of States Against Corruption (GRECO), a peer monitoring organization that allows members to assess anticorruption efforts on a continuing basis. An evaluation of Croatia, including suggestions and opinions on Croatia's progress in its fight against corruption, can be found on GRECO's website. In terms of regional co-operation, Croatia is engaged in the regional anti-corruption initiative (RAI--formerly SPAI), the Program Against Corruption and Organized Crime in South-Eastern Europe (PACO), and the PACO impact project for the implementation of anti-corruption plans. Croatia has been a member of Interpol since 1992. Croatia also cooperates regionally through the Southeast European Co-operative Initiative (SECI), the Adriatic Ionian Initiative, the Southeast Europe Police Chiefs Association (SEPCHA), and the Central European Initiative (CEI).

¶68. Corruption is perceived to be pervasive in the health sector, universities, public procurement, construction sector, land registry offices, and the privatization fund.

¶69. The Croatian Criminal Code and the Criminal Procedure Act provide for the prosecution of different forms of corruption and similar criminal acts.

Additional laws that deal with suppression of corruption include the Act on the Office for the Prevention of Corruption and Organized Crime (Law on USKOK), the State's Attorney Office Act, the Public Procurement Act, the Budget Act, the Courts Act, the Conflict of Interest Prevention Act, the Corporate Criminal Liability Act, the Money Laundering Prevention Act, the Witness Protection act, the Personal Data Protection Act, the Right to Access to Information Act, the Act on Public Services, the Code of Conduct for Public Officials, the Code of Conduct for Judges. The Croatian Criminal Code covers such acts as trading in influence, abuse of functions, bribery in the private sector, embezzlement of property in the private sector, and concealment and obstruction of justice.

¶70. Giving or accepting bribes is a criminal act. The minimum prison sentence for an act of bribery (Articles 348(1) and 294b (1), Criminal Code) is six months and the maximum sentence is three years. In two forms of passive bribery (Articles 347 and 294 (A), Criminal Code), sentences range from one to eight years imprisonment, depending on the crime.

Bribes by a local company to a foreign official are punishable under Croatian law. If it is established that a local company is the legal entity committing crimes, that company might receive a ban for conducting operations, depending on the gravity of the crime.

¶71. The Office for the Prevention of Corruption and Organized Crime (USKOK), which is the agency responsible for battling corruption, is currently staffed by 36 employees and participates in joint task forces with the Ministry of Finance and the police. USKOK is mandated to direct police investigations and conduct prosecutions in corruption and organized crimes cases. The criminal offenses under USKOK are strictly enumerated in the USKOK law. USKOK headquarters are in Zagreb with branch offices in Split, Rijeka and Osijek.

The Ministry of Interior, the Office for Suppression of Money Laundering, the Tax Administration, the Anti-Corruption Unit of the Ministry Of Justice and the National Council for Monitoring the Implementation of the National Program for Suppression of Corruption all have a proactive role in combating corruption.

¶72. Transparency International Croatia is the main non-governmental agency watchdog in Croatia. GONG, a non-partisan citizens' organization founded in 1997, conducts non-partisan monitoring of the election process, educates citizens about their rights and duties, encourages mutual communication between citizens and their elected representatives, promotes transparency of work within public services, and manages public advocacy campaigns and encourages and helps citizens in self-organizing initiatives. Partnership for Social Development is another NGO that deals with the suppression of corruption.

A.11.b Bilateral Investment Agreements

¶73. Croatia does not have a foreign investment law; foreigners receive national treatment under existing legislation. In addition, investments by American citizens are covered by the U.S. Croatian Bilateral Investment Treaty (BIT), which entered into force in June 2001. The treaty fulfills the principal U.S. objectives for

ZAGREB 00000026 010 OF 013

agreements of this type:

-- All forms of U.S. investment in the territory of Croatia are covered;

-- Covered investments receive the better of national treatment or most-favored-nation (MFN) treatment, both while they are being

established and thereafter, subject to certain specified exceptions;

-- Specified performance requirements may not be imposed upon or enforced against covered investments;

-- Expropriation is permitted only in accordance with customary international law standards;

-- Parties are obligated to permit the transfer, in a freely usable currency, of all funds related to a covered investment, subject to exceptions for specified purposes;

-- Investment disputes with the host government may be brought by investors, or by their covered investments, to binding international arbitration as an alternative to domestic courts.

¶74. For further information about BITs and for the text of the U.S.-Croatian BIT please see www.mac.doc.gov/Tcc/e-guides/eg_bits (under "Croatia").

¶75. Croatia has signed investment protection treaties/agreements with the following countries, however, not all have entered into force:

Albania, Argentina, Austria, Belgium, Belarus**, Bulgaria, Bosnia and Herzegovina, Czech Republic, Chile, Denmark, Egypt, Finland, France, Greece, Germany, India, Indonesia**, Iran, Italy, Israel, Jordan, Kuwait, Cambodia, Canada, Qatar*, China*, Cuba**, Latvia, Libya, Hungary, Macedonia, Malaysia*, Malta, Republic of Moldova**, Netherlands, Oman**, Poland, Portugal, Romania, Russia*, United States, Serbia Montenegro, Slovakia, Slovenia**, Spain, Sweden, Switzerland*, Thailand*, Turkey, United Kingdom, Ukraine, Zimbabwe*.

(* = ratified, but not in force) (** = not ratified or in force)

A.11.c OPIC and Other Investment Insurance Programs

¶76. Croatia is eligible for financing and political risk insurance coverage from the U.S. Overseas Private Investment Corporation (OPIC). In 2004, OPIC provided \$250 million in political risk insurance to support financing for the construction of a motorway in Croatia that will do much to improve the country's infrastructure, reduce transportation costs, and develop the tourism potential of the Dalmatian coast. OPIC provided the insurance to Private Export Funding Corporation (PEFCO) to support PEFCO's financing to Croatian Motorways, ltd. for construction of a portion of the Zagreb-Split motorway, consisting of a tolled four-lane highway connecting Bregana and Zagreb, and Bosiljevo with Sveti Rok. In 1998, OPIC supported a \$200 million private equity fund, Southeast Europe Equity Fund I, managed by Bedminster Capital Management, which invested in the Croatian banking sector (as part of the consortium that purchased Dubrovacka Banka) and the Croatian communications sector (by investing in Digital City Media, a broadband cable tv network in Croatia). Bedminster Capital Management's successor fund, Southeast Europe Equity Fund II, which has OPIC support, also targets investments in Croatia, among other countries. For more information about OPIC, see www.opic.gov.

Croatia is a member country of the Multilateral Investment Guarantee Agency (MIGA), for more information see www.miga.org.

¶77. In the event that OPIC should pay an inconvertibility claim under its political risk coverage, the local currency accepted by OPIC in any subsequent recovery would be made available to the Embassy on a priority basis for U.S. Government expenses. The estimated annual U.S. dollar value of local currency used by the Embassy is approximately \$16 million. The Embassy currently purchases local currency from a local commercial bank at the market rate. A major devaluation is considered unlikely.

A.11.d Labor

¶78. Croatia has an educated, highly-skilled, and relatively high cost labor force compared with the region. In general, employer's wage costs are approximately 110 percent of an employee's net wage.

The estimated average cost to employers in Croatia was 7,621 HRK (approximately \$1524.20) per month as of October 2008. The average net wage at the end of the third quarter of 2008 was 5,263 HRK

ZAGREB 00000026 011 OF 013

(\$1052.60). The manner of calculating minimum wage was amended in 2008 per the Minimum Wage Act. The Act introduced a substantial one-time wage increase and the adjustment formula stipulated by the Act ensures a continuous minimum wage increase over a longer period of time. Minimum wage raises will be calculated from the minimum-to-average-wage ratio from the previous year, increased by the percent equal to real GDP growth in the previous year. Certain suggested alternative calculations for various sectors are under review by the constitutional court.

¶79. Croatia's labor laws are aimed at increasing labor market flexibility by shortening the mandatory notification period before dismissal and reducing generous severance package requirements. However, Croatia still fares badly in terms of time and expense in hiring and firing employees. Labor has generally been supportive of government efforts to boost competitiveness and welcomes foreign investment, but remains concerned about any possible cuts in social spending.

¶80. The Law on Labor regulates employee and employer relations through "employment contracts." Fulltime employment must not amount to more than 40 hours per week and employees are entitled to at least four weeks of paid annual leave and seven days of personal leave. The Law on Labor also provides special protections for workers in dangerous occupations, work at night, and work by minors between the ages of 15 and 18.

¶81. Chapter 7 of the Law on Foreigners covers the issuance of work permits. While there are quotas (determined annually) for work permits, there are no quotas for foreigners who execute key positions in companies or representative offices. Likewise, there are no quotas for business visas.

¶82. Workers are entitled by law to form or join unions of their own choosing, and workers exercised this right in practice. In general, unions were independent of the government and political parties. The Labor Code prohibits anti-union discrimination and expressly allows unions to challenge firings in court; however, in general, attempts to seek redress through the legal system were seriously hampered by the inefficiency of the court system.

A.11.e Foreign Trade Zones/Free Ports

¶83. Croatia has several Free Trade Zones (FTZs), some in war-affected areas. Special incentives are offered to users of FTZs.

¶84. The Law on Free Trade Zones allows a foreign-owned or domestic company in FTZs to engage in manufacturing, wholesale but not retail trade, foreign trade, banking and other financial activities. The Law on Profit Tax also covers business in FTZs. FTZ users are eligible for tariff waivers on imported products. FTZ users who construct or participate in construction of infrastructure projects worth 1 million HRK (about \$178,000) or more in the zone, are exempted from paying corporate tax during the first five years of operation in the zone. Other users in the zone pay corporate tax in the amount of 50 percent of the regular rate (i.e., 10 percent instead of 20 percent).

¶85. FTZs are exempted from any Croatian emergency measures or other restrictions pertaining to foreign trade or hard currency transactions. Users of the zones may freely store their goods and production equipment in the zones. Goods that are not intended for trade on the Croatian market or for domestic consumption are fully exempt from custom duties or taxes. Imported goods will be taxed and assessed duties per the value of the production materials imported for the product and not per the value of the finished product.

¶86. The following fifteen counties currently have FTZs: Buje,

Krapina-Zagorje, Osijek, Rijeka, Slavonski Brod, Split, Splitsko-Dalmatinska County, Obrovac, Ploce, Pula, Kukuljanovo, Varazdin, Zagreb, Vukovar, and Ribnik counties. As mentioned previously, EU accession will force the Government to make changes in the free trade zone system and the incentives system associated with them.

A.11.f Foreign Direct Investment Statistics

187. Compared to other advanced transitional economies in the region, Croatia is in the middle group in terms of foreign direct investment (FDI). New or green-field investments have seen particularly slow growth. According to the Trade and Investment Promotion Agency, there was one large-scale foreign investment project initiated this year (see list below paragraph 85). Privatization of strategic government-owned assets has been the main

ZAGREB 00000026 012 OF 013

source of FDI since Croatian independence. Large state assets such as utilities, the state insurance company and banks, are being sold by the government, usually through international tenders, and in some cases, through initial public offerings (IPOs), as was the case recently with the state oil company, INA, and the national telecom, HT. The Croatian Privatization Fund, the agency responsible for the sale of other assets, has shares and stock in 1112 (mostly non-performing) companies. The state's share of the equity base value of these companies is about 21.8 billion HRK (\$4.36 billion). Information regarding the Croatian Privatization Fund, including information on companies currently for sale, can be found on its website, www.hfp.hr.

188. There were no significant sales made by the government in terms of privatization efforts in 2008. In 2007, the Croatian government offered to the public first rights for purchase of its 32.5 percent stake in Croatia Telecom (Germany's Deutsche Telekom is the majority shareholder), of which 25 percent were reserved as priority for Croatian citizens. Individual purchase was limited to 16,695 HRK (\$3,227) and included the offer of one free share for every ten retained for at least a year. About 358,400 citizens participated in this offer and purchased shares at the cost of 265 HRK (\$71) each.

189. Foreign Direct Investment between 1993 and the second quarter of 2008 totaled \$19.5 billion, with investments in the financial, chemical and telecommunications sector accounting for 58 percent of total investment. Croatian firms invested \$2.1 billion abroad between 1993 and the second quarter of 2008. It is estimated that inflow FDI for the first two quarters of 2008 amounted to 3 percent of GDP and that outflow FDI for the first two quarters of 2008 is estimated at under one percent.

190. According to official statistics from the Croatian National Bank, Austria is the largest source of foreign investment in Croatia, accounting for 30.6 percent of total FDI since 1993. The Netherlands is second with 15.2 percent of total FDI, followed by Germany with 12.6 percent and France with 7 percent. Because transactions are often executed through third countries and the Croatian National Bank records country of origin of the final transaction leading to the investment, in many cases, this results misleading statistics. The U.S. Embassy Zagreb estimates that the actual amount of U.S. investment in Croatia was approximately \$ 2.5 billion. However, the US investment referenced to in recent years was the purchase of Pharmaceutical company Pliva by US company Barr Pharmaceuticals, which was bought out at the global level by Israeli Teva in December 2008 (see list in paragraph 91). The leading destinations for total Croatian investment, from 1993 to the second quarter 2008, were the Netherlands with 24, Bosnia-Herzegovina with 18 percent and Serbia with 17 percent. In the first two quarters of 2007, Croatians invested \$11 million abroad. The Netherlands was the lead investment destination for 2008 followed by Bosnia Hercegovina and Serbia.

191. The Croatian National Bank provides information about foreign investments in aggregate form which can be found on their website at www.hnb.hr. The following includes some major (\$20 million and above) foreign investments in Croatia to date listed at investment

value at the time of the transaction (current values are not available):

Foreign investor: GP&Partners (Dutch)
Corn starch factory
Value: \$103 million

Foreign investor: Barr Pharmaceuticals (U.S)
Pharmaceuticals (which was bought out by Israeli Teva in December 2008)
Croatian company: Pliva
Value: \$2.3 billion

Foreign investor: Deutsche Telekom (Germany)
Telecommunications
Croatian Company: Croatian Telecom (51 percent of shares)
Value: \$1.272 billion

Foreign investor: MOL (Hungary)
Oil Industry
Croatian Company: INA d.d. (26 percent of shares in 2003 plus 21.15 percent in 2008)
Value: \$505 million + \$1.3 billion

Foreign investor: Lactalis (France)
Dairy
Croatian company: Dukat
Value: \$400 million

Foreign investor: Banca Commerciale Italiana (Italy)
Banking/financial services

ZAGREB 00000026 013 OF 013

Privredna Banka (66.66 percent of shares in 1999 plus 10 percent in 2002)
Value: \$300 million + approximately \$50 million, according to media reports

Foreign investor: Unicredito Italiano (Italy)
TAKEN OVER BY BANK AUSTRIA IN 2007
Banking/financial services
Zagrebacka Banka (96 percent ownership)
Value: \$230 million (estimate)

Foreign investor: Erste und Steiermarkische Bank (Austria)
Banking/financial services
Rijecka Banka (85 percent share)
Value: \$155 million

Foreign investor: Austria Creditanstalt Group (HVB Group) (Austria)
TAKEN OVER BY SOCIETE GENERAL IN 2006
Banking/financial services
Splitska Banka (88 percent ownership)
Value: \$132 million

Foreign investor: Heineken N.V. (Netherlands)
Brewery
Karlovacka Pivovara company (94.42 percent)
Value: \$125 million

Foreign investor: Rockwool Group (Denmark)
Stone wool producers
Value: \$110 million

Foreign investor: Sutivan Investment and Excelsa Anstalt (Lichtenstein)
Hotels and tourism
Plava Laguna (81.5 percent)
Value: \$70 million

Foreign investor: CMC (U.S / Switzerland)
Steel
Croatian company: Sisak Steel Company
Value: \$52 million

Foreign investor: Ericsson (Sweden)

Telecommunications
Tesla Company
Value: \$48 million

Foreign investor: Hofmann and Pankl Betelligungasse (Austria)
Minerals processing
Straza Company
Value: \$39 million

Foreign investor: Societe Suisse de Cemment Portland (Switzerland)
Cement
Tvornica Cementa Koromacno company
Value: \$38 million

Foreign investor: Applied Ceramics (U.S)
Semi-conductor components
Value: \$30 million

Foreign investor: Interbrew (Belgium)
Brewery
Zagrebacka Pivovara company
Value: \$27 million

Foreign investor: Coca Cola Amatil (Australia)
Non-alcoholic beverages
Croatian company: n/a
Value: \$20 million

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